

# Liability of Lawyer-Directors

WILLIAM E. KNEPPER\*

## I. INTRODUCTION

Many businessmen and lawyers believe that lawyers are well-qualified to serve as corporate directors. Corporations ask legal counsel to serve on their boards because they believe it beneficial to the company. Counsel usually brings to his board position considerable knowledge of the corporation's business as well as of its legal problems.

In today's climate of expanded director liability under both state and federal law, lawyer-directors must expect to be targets of litigation. Regulatory authorities are extending the concepts of professional liability which compound when lawyers serve in the dual roles. Enough problems have emerged that lawyer organizations are studying this area in depth.<sup>1</sup>

This article will consider the extent to which lawyers function in this dual capacity and the basis for opposition to the practice. It will note the constraint upon advocates and corporate legal advisers when they undertake to serve as corporate directors. It will discuss some of the more important complications that a lawyer faces when he puts on the second hat of a corporate director, including (1) the difficulty of identifying his corporate client; (2) the decision to be an "inside" or "outside" director and the probable increase in his legal liability; (3) problems relating to responses by his law firm to auditors' requests for information; (4) his compounded liability under the securities laws; (5) the loss of his independence; (6) the probable loss of the attorney-client privilege; (7) his status as a deputy for his law firm; (8) significant conflicts of interest; and (9) questions of liability insurance coverage for the multiple risks he undertakes.

Without reaching a specific conclusion on the principal question, the article recognizes an apparent trend toward the view that major suppliers of services to a corporation, such as lawyers, investment bankers, accountants and commercial bankers probably should be excluded from board membership, at least until more definitive decisions clear the air.

## II. LAWYER-DIRECTORS

### A. *A Widespread Practice*

Two thousand major corporations paid more than \$270 million in 1977 to 1200 law firms whose partners also served as directors or officers of those companies.<sup>2</sup> This information, disclosed under regulations of the

---

\*Adjunct Professor of Law, Ohio State University College of Law

1. Portions of this article are derived from a seminar conducted by the author for the American College of Trial Lawyers at Boca Raton, Florida, March 12, 1979.

2. Lavine, *Lawyers as Directors: Big Bucks*, Nat'l L.J., Sept. 25, 1978, at 1, col. 4, and 6, col. 1.

Securities and Exchange Commission (SEC; Commission), did not include corporations not publicly listed. Although, as these figures indicate, the lawyer-director practice is common, a 1978 survey reported that more companies had eliminated the double relationship with their lawyers from 1976 to 1978 than in the previous two-year period.<sup>3</sup> The reasons given for this decline in lawyer-directors included "the outward appearance and potential for criticism." One prominent Washington lawyer recalled the old maxim, "the lawyer who has himself for a client has a fool for a client," yet that same lawyer was listed as an inside partner, the term applied in the survey to lawyers serving in the dual capacity of lawyer-director.<sup>4</sup> This list of inside partners included some of the most prestigious names at the American bar.

Mr. Justice Stewart has spoken of "the need for the brightest possible line of demarcation between the function of a lawyer in giving professional counsel to his client, and the function of corporate management in carrying on the corporation's business in the profit-making interests of its stockholders."<sup>5</sup> The lawyer who serves in the dual capacities of corporate counsel and corporate director must either straddle that line or walk it as a tightrope. As he does so, the propriety of his dual capacity remains, in Mr. Justice Stewart's words, "a vexing problem of professional responsibility."<sup>6</sup>

### B. *The Problem in Context*

To put our problem in proper context, let us suppose that Mr. Clarence Counselor and Mr. Abner Advocate are senior partners in a mythical, prestigious law firm that is general counsel for a Fortune 500 corporation listed on the New York Stock Exchange. Its chief executive officer tells the law firm that the corporation wants either Mr. Counselor or Mr. Advocate to become a member of the company's board of directors. Such a request is usually deemed to be a command; it contemplates that the law firm will continue as general counsel for the corporation.

We begin our discussion with the declaration of the Business Roundtable that "[t]he first corporate obligation . . . —an obligation to both owners and employees—is profitable operation."<sup>7</sup> As a corporate director, Mr. Counselor or Mr. Advocate will undertake that as his own first obligation; as a business lawyer, he will expect to provide his total ability and effort to his client. He must be competent as a professional in providing legal advice for the businessman who retains him.

---

3. *Id.*

4. Lavine, *supra* note 2, at 6, col. 1.

5. Stewart, *Professional Ethics for the Business Lawyer: The Morals of the Market Place*, 31 BUS. LAW. 463, 464 (1975).

6. *Id.*

7. *Statement of the Business Roundtable—The Role and Composition of the Board of Directors of the Large Publicly Owned Corporations*, 33 BUS. LAW. 2083, 2100 (1978).

Does the lawyer-director's dual role prevent his strict adherence to a lawyer's principles of objectivity and independence? Can he better serve the public interest than by giving the best possible legal advice to his clients?<sup>8</sup>

The questions are not really that easy. Management hires and fires corporate counsel. Counsel has the function of identifying risks and alerting the corporate decision-makers to the legal consequences of taking risks. Can counsel expect his fellow directors to accept his identification of risks as an independent legal judgment if, as a director, he decides to go along with a management proposal which he, as counsel, defines to be legally hazardous? If counsel follows his own legal advice, and votes against management, is he properly performing his director's function? Perhaps of equal importance, can he act independently and still protect his law firm's economic interest in maintaining the corporation as its client?

It has been suggested that when corporate counsel becomes a director, even the selection of his law firm to perform services for the corporation may be subject to challenge.<sup>9</sup> Certainly, fees charged by the law firm should be scrutinized for fairness, with the burden of supporting the fairness imposed upon the law firm.<sup>10</sup>

### C. *Advocate or Advisor*

While putting our problem in context, we suggested that either of two partners in our mythical law firm—Clarence Counselor or Abner Advocate—could be named to the corporation directorship. That choice may have some significance. Although a lawyer may serve simultaneously as an advocate and as an adviser, the two roles are essentially different.

Historically, lawyers have been viewed principally as advocates. The Code of Professional Responsibility gives an advocate the widest possible latitude. The advocate "may urge any permissible construction of the law favorable to his client, without regard to his professional opinion as to the likelihood that the construction will ultimately prevail."<sup>11</sup> He should resolve in his client's favor all doubts regarding the bounds of the law.<sup>12</sup> He may take any position supported by the law or "supportable by a good faith argument for an extension, modification, or reversal of the law."<sup>13</sup>

The lawyer's traditional role as an advocate is inconsistent with the modern practice of the corporate lawyer, who sometimes acts more as an auditor than an advocate. The corporate lawyer must be acutely aware of his duties to those relying on his expert opinion on matters concerning the

---

8. Stewart, *supra* note 5, at 468.

9. Ruder, *The Case Against the Lawyer-Director* 30 (Special Issue) *BUS. LAW.* 51, 54 (1975) (panel discussion on *Lawyers as Directors*).

10. *Id.*

11. ABA CANONS OF PROFESSIONAL ETHICS No. 7, E-C 7-4 [hereinafter cited as ABA CANONS].

12. *Id.*, E-C 7-3.

13. *Id.*, E-C 7-4.

client corporation.<sup>14</sup> It has been suggested that the corporate lawyer "will have to exercise a measure of independence that is perhaps uncomfortable if he is also the close counselor of management in other matters, often including business decisions."<sup>15</sup> In his practice, the corporate lawyer represents corporations whose shares are held by members of the public, either directly or as participants in retirement plans, mutual funds and the like, and whose business activities affect large numbers of employees and the national economy. He is usually indispensable to the consummation of securities transactions and many business transactions in which his legal opinion is a customary condition of the closings.<sup>16</sup>

As to our Mr. Counselor, the code of Professional Responsibility views the legal adviser's rights and duties in contradistinction to those of the advocate. He primarily assists his client in determining the course of future conduct and relationships.<sup>17</sup> The legal adviser is expected to opine what the courts will ultimately decide to be the applicable law and inform his client of the practical effect of such a decision.<sup>18</sup> He may not knowingly assist the client in engaging in illegal conduct or take a frivolous legal position.<sup>19</sup> He must act competently and is prohibited from engaging in conduct involving dishonesty, fraud, deceit or misrepresentation.<sup>20</sup>

Even if the corporation has an in-house legal staff competent to handle most of its legal problems, excluding litigation, it is likely that Mr. Counselor, the adviser, rather than Mr. Advocate will be selected to serve on its board. When Mr. Counselor puts on this second hat, he faces new complications, some of which will be the subject of further consideration.

#### D. *Complications Facing the Lawyer-Director*

##### 1. *Who is the Client?*

The corporate lawyer has obligations to the various financial interests involved in the corporate business.<sup>21</sup> He is told by the Canons that he owes "his allegiance to the entity [the corporation] and not to a stockholder, director, officer, employee, representative, or other person connected with the entity."<sup>22</sup> However, it is not always easy to define the entity's interest in contrast to that of the others mentioned. Thus his obligations to those others must be dealt with on their merits.

In identifying a corporate lawyer's client, judicial recognition of the rights of stockholders, and the obligations of directors and lawyers to defend those rights, has raised stockholders to a preferred position.<sup>23</sup> If their corporation is not managed in a lawful manner and for their benefit, the corporation's lawyer will be obligated to disclose these facts to the

---

14. Gates & Zilly, *Legal Malpractice*, in PROFESSIONAL RESPONSIBILITY 311, 318 (ABA Standing Committee on Continuing Education of the Bar 1978).

15. Sommer, *The Emerging Responsibilities of the Securities Lawyer*, [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶79,631, at 83-689.

16. Frank, *A Higher Duty: A New Look at the Ethics of the Corporate Lawyer*, 26 CLERK, ST. L. REV. 337, 339-40 (1977).

stockholders. When counsel serves as a director and corporate counsel, no allegiance to his position in management will allow him to conceal management's derelictions from the stockholders, and this may require him to disclose his own transgressions as a part of management.

The traditional concept that corporate counsel's first allegiance is strictly to the entity,<sup>24</sup> and thus to management, has been eroded by recent court decisions. Of primary concern is *Garner v. Wolfinbarger*, in which the Fifth Circuit Court of Appeals rejected the strict entity position asserted by the American Bar Association in its amicus curiae brief.<sup>26</sup> The case dealt with the availability of attorney-client privilege in a shareholder class and derivative action against the company and its management. Holding that any privilege would arise not "from the position of the corporation as a party but its status as a client,"<sup>27</sup> the court noted that "management does not manage for itself and that the beneficiaries of its action are the stockholders."<sup>28</sup> The court concluded that a corporate attorney represents joint clients, the corporation and its stockholders.<sup>29</sup>

An earlier decision of the Second Circuit took an important step in the same direction when that court found "no justification for interposing the corporate fiction between the directors and the minority stockholders who were the victims of the directors' fraudulent actions."<sup>30</sup> The trend of the federal decisions is to recognize that the duty of a corporate lawyer runs not only to the corporate entity but also to its stockholders and, at least in certain circumstances, to the public.<sup>31</sup>

## 2. *Insider or Outsider: Increase in Liability*

When retained outside counsel for a corporation becomes a member of its board, does he serve as an "inside" or an "outside" director? The ABA

---

17. ABA CANONS, *supra* note 11, No. 7, E-C 7-3.

18. *Id.*, E-C 7-5.

19. *Id.*

20. Shipman, *The Need for SEC Rules to Govern the Duties and Civil Liabilities of Attorneys Under the Federal Securities Statutes*, 34 OHIO ST. L.J. 231, 271 (1973) [hereinafter cited as Shipman I].

21. Marsh, *Relations with Management and Individual Financial Interests*, 33 BUS. LAW. 1227 (1978).

22. ABA CANONS, *supra* note 11, No. 5, E-C 5-18.

23. See notes 71-89 and accompanying text *infra*.

24. ABA CANONS, *supra* note 11, No. 5, E-C 5-18.

25. 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971). See also *Garner v. Wolfinbarger*, 56 F.R.D. 499 (S.D. Ala. 1972).

26. 430 F.2d at 1102.

27. *Id.* at 1097.

28. *Id.* at 1101.

29. See also Shipman, *Professional Responsibilities of the Corporate Lawyer*, in PROFESSIONAL RESPONSIBILITY 271, 275 (ABA Standing Committee on Continuing Education of the Bar 1978) [hereinafter cited as Shipman II].

30. *Schoenbaum v. Firstbrook*, 405 F.2d 200, 215 (2d Cir. 1968).

31. Frank, *supra* note 16, at 350, 352.

Corporate Director's Guidebook calls him an "affiliated non-management director."<sup>32</sup> In *Feit v. Leasco Data Processing Equipment Corp.*,<sup>33</sup> however, the court termed him a management director rather than an outside director. He "was so intimately involved . . . that to treat him as anything but an insider would involve a gross distortion of the realities of Leasco's management."<sup>34</sup>

In the SEC's proposed amendments to its reporting requirements, the Commission proposed to require that the proxy statement relating to the annual election of directors identify nominees as "management directors," "affiliated nonmanagement directors," or "independent directors."<sup>35</sup> Under that proposal, the term "affiliated nonmanagement director" would have included "any person who is a member or employee of, or is associated with, a law firm which is proposed to be, or within the last two years has been, retained by the corporation."<sup>36</sup> Because of objections to the proposed categorization of directors, the Commission withdrew the requirements and, taking the opposite view, now cautions against the use of labels because of their misleading nature.<sup>37</sup> It is significant, however, that the Commission continues to require disclosure in the proxy statement of the relationship of such lawyers to the corporation issuing the statement.<sup>38</sup> The Commission takes the position that there are "inherent conflicts faced by lawyers who serve both as directors and as counsel to corporations . . . ."<sup>39</sup>

It seems likely that the corporate attorney who acts as lawyer and director must face the reality that he will be held to the same standard of care as inside directors.<sup>40</sup> In addition, he will be held to a standard of care commensurate with his knowledge of the law, his special skills as a business lawyer, and his probable involvement with the matter at hand.<sup>41</sup> Thus his duty will be to exercise "such care as the ordinarily prudent lawyer-director would use under similar circumstances in a like position."<sup>42</sup> As Judge McLean appeared to insist in *Escott v. BarChris Construction Corp.*: "A director who possesses some special expertise—such as a lawyer,

32. ABA, CORPORATE DIRECTOR'S GUIDEBOOK, reprinted in 33 BUS. LAW. 1591, 1620 (1978). The Guidebook does not address the issue whether a lawyer should serve on his client's board of directors.

33. 332 F. Supp. 544, 575-76 (E.D.N.Y. 1971).

34. *Id.* at 576.

35. Securities Exchange Act Release No. 34-14970 (July 18, 1978), [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶81,645, at 80,578-79.

36. *Id.* at 80,578.

37. Securities Exchange Act Release No. 15384 (Dec. 6, 1978), [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶81,766, at 81,092-93 (Schedule 14A, Note to Item 6(b)(7)).

38. *Id.* at 81,092 (Schedule 14A, Item 6(b)(4)).

39. *Id.*

40. Harris, *The Case for the Lawyer-Director*, 30 BUS. LAW. 58, 59 (1975) (panel discussion on *Lawyers as Directors*).

41. Ruder, *supra* note 9, at 55.

42. W. KNEPPER, LIABILITY OF CORPORATE OFFICER AND DIRECTORS 427 (3d ed. 1978).

accountant or real estate specialist—is expected to apply this expertise to those board deliberations involving his specialty.”<sup>43</sup>

The Committee on Grievances of the New York City Bar Association maintains that “a line executive who is a lawyer has an even graver obligation, as one who knows the law, to stand against practices that betray the trust upon which the very life of our business economy depends.”<sup>44</sup>

To like effect is the comment of the American Bar Association Committee that under Section 35 of the Model Business Corporation Act, “the special background and qualifications a particular director may possess, as well as his other responsibilities (or their absence) in the management of the business and affairs of the corporation, may place a measure of responsibility upon such director . . . which may differ from that placed upon another director.”<sup>45</sup>

The corporate lawyer who does little more than prepare documents, tend to their proper execution, and give strictly legal advice on questions presented to him will have substantially less potential liability than the more active participant in corporate affairs.<sup>46</sup> A lawyer-director who goes beyond that role is in a different position.<sup>47</sup> The distinction was noted by the Ninth Circuit in relieving a corporate lawyer, who was not a director, from liability in a monopolization case because he did not, acting by himself or jointly with others, make policy decisions for the corporation.<sup>48</sup> A contrary result was reached in a California case. The corporate lawyer prepared an application for a permit to sell stock; as a director he voted to file the application; as corporate secretary he signed the application. The court held that his knowledge of the stock’s worthlessness could not be denied on any theory.<sup>49</sup>

Professor Morgan Shipman points out that the SEC has successfully accelerated the trend toward greater duties for outside directors, especially independent directors.<sup>50</sup> But the lawyer-director whose law firm also serves as corporate legal counsel will probably be treated as an inside director whose independence is at least suspect.<sup>51</sup>

---

43. 283 F. Supp. 643 (S.D.N.Y. 1968), *reprinted in* Luce, *Responsibilities of Directors* Dun’s (Nov. 1973).

44. New York Law Journal, April 25, 1974, at 4, col. 5.

45. Report of Committee on Corporate Laws, *Changes in the Model Business Corporation Act*, 30 BUS. LAW. 501, 506 (1975).

46. Gates & Zilly, *supra* note 14, at 326.

47. See *Symposium —A Critical Examination of Some Evidentiary Privileges*, 56 NW. U.L. REV. 206, 235 (1961).

48. Tillamook Cheese & Dairy Ass’n v. Tillamook County Creamery Ass’n, 358 F.2d 115, 118 (9th Cir. 1966).

49. Strahan v. Rodney, 97 Cal. App. 2d 448, 217 P.2d 711 (1950).

50. Shipman II, *supra* note 29, at 273. See also *Outsiders on the board face an SEC squeeze*, BUSINESS WEEK, July 16, 1979, at 35.

51. See text accompanying notes 71-87 *infra*.

The duties of care of the lawyer-director in dealing with corporate legal matters, especially securities matters, may be far greater than common law reasonableness or the standards outlined in the Code of Professional Responsibility.<sup>52</sup> The lawyer-director's familiarity with the corporation's affairs will probably justify imposing on him responsibilities similar to those of directors who are officers and full-time employees of the corporation.<sup>53</sup> As a mere director, he owes a fiduciary duty of utmost confidence and trust to the corporation, its stockholders, and probably to the offerees and purchasers of its securities.<sup>54</sup> In his dual capacity, the liability of the lawyer-director will be affected by his experience, knowledge, relationship to the corporation and its management, intimacy of involvement in its affairs and his awareness of the consequences of corporate acts.<sup>55</sup> The lawyer-director will be expected to be more professional in his work than would the ordinary director without professional training.

The lawyer-director can count on being a special target of litigation and is more apt to be sued as a primary wrongdoer than as an aider and abettor.<sup>56</sup> For example, in a Second Circuit decision, a lawyer who had gone beyond his professional function as a lawyer by participating in a sale transaction was held to be within the reach of section 12(2) of the Securities Act.<sup>57</sup>

### 3. *Responses to Auditors' Requests for Information*

The professional auditor must rely upon the corporate lawyer to supply information needed to formulate an opinion on the financial condition of the company and the results of its operations for the period included in the financial statements.<sup>58</sup> The chief difficulty of the lawyer in responding to an auditor's requests lies in the area of contingent liabilities for unasserted claims.

The lawyer's statements to the accountant must be based on available facts and information.<sup>59</sup> On that basis, as a lawyer, he has a duty to advise his client regarding the likelihood that a claim will be asserted. As a director, in which capacity he acts as the client, the lawyer-director will have the further duty of considering the possibility of the claim's

---

52. Gates & Zilly, *supra* note 14, at 318.

53. W. KNEPPER, *supra* note 42, at 25.

54. Pepper v. Litton, 308 U.S. 295 (1939); See Escott v. BarChris Constr. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968).

55. Sommer, *Directors and the Federal Securities Laws*, [1973-1974 Transfer Binder] F&D. SEC. L. REP. (CCH) ¶79,669, at 83,806.

56. See text accompanying notes 79-87 *infra*.

57. Katz v. Amos Treat & Co., 411 F.2d 1046 (2d Cir. 1969).

58. ABA Section of Corporate, Banking and Business Law, *Scope of Lawyers' Responses to Auditors' Requests for Information*, 30 BUS. LAW. 513, 520 (1975) (rev. exposure draft, Aug., 1974).

59. ABA *Statement of Policy Regarding Lawyers' Responses to Auditors' Request for Information*, reprinted in 32 BUS. LAW. 177, 180-81 (1976).



unfavorable outcome and its materiality.<sup>60</sup> The corporate client, through its management should determine whether to disclose the unasserted claim to the auditor.<sup>61</sup> If the lawyer is also a director, he will be participating in the determination of the need for such disclosure in the corporation's financial statement. This appears to broaden the lawyer-director's responsibilities beyond those generally imposed upon a corporate lawyer under the statement of policy and principles issued by the American Bar Association and the American Institute of Certified Public Accountants.<sup>62</sup>

For example, if corporate management were to withhold information regarding a contingent claim from the company's lawyer and not include it in the list provided to him, he would have no duty to disclose it to the auditor.<sup>63</sup> If, however, the lawyer were also a corporate director, he would, presumably, be expected to know of the existence of the claim, the likelihood of an unfavorable outcome, and its materiality. This knowledge would probably not be shielded by the attorney-client privilege because it would have come to the lawyer-director in a business relationship instead of an attorney-client relationship.<sup>64</sup>

The lawyer-director may incur particular problems under the Securities Exchange Act when his firm is required to respond to auditor's inquiries.<sup>65</sup> In a release dated February 15, 1979,<sup>66</sup> the SEC announced the adoption of two new rules to promote the reliability of information filed by issuers with the Commission or disseminated to investors.<sup>67</sup> One of those rules prohibits officers and directors of an issuer from directly or indirectly making materially false, misleading or incomplete statements to an accountant in connection with any audit or examination of the financial statements of the issuer or the filing of any document or report required to be filed with the Commission.<sup>68</sup> This rule is applicable to any director or officer of any issuer and relates to oral as well as written communications.<sup>69</sup> Controlling persons of an issuer may be held liable for violative conduct under section 20 of the Securities Exchange Act.<sup>70</sup> It appears that the rule

---

60. *Id.* at 180.

61. *Id.* at 184.

62. See Note, *Attorney Responses to Audit Letters: The Problem of Disclosing Loss Contingencies Arising From Litigation and Unasserted Claims*, 51 N.Y.U. L. REV. 838 (1976).

63. See Auditing Standards Executive Committee, ASCPA, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, 8 SEC. L. REV. 521, 524 (1976).

64. See *Federal Savings & Loan Ins. Corp. v. Fielding*, 343 F. Supp. 537, 546 (D. Nev. 1972).

65. See generally W. KNEPPER, *supra* note 42, at 440.

66. Securities Exchange Release No. 15570 (Feb. 15, 1979) [Current] FED. SEC. L. REP. (CCH) ¶81,959 (Mar. 1, 1979).

67. Rules 13b2-1 and 13b2-2, 44 Fed. Reg. 10970 (1979) (to be codified in 17 C.F.R. §§ 240.13b2-1, 240.13b2-2).

68. Rule 13b2-2, *supra* note 67.

69. Securities Exchange Release No. 15570, *supra* note 66, at 81,400.

70. *Id.* See also 15 U.S.C. § 78t (1976).

will apply to communications between a law firm and accountants for an issuer when a partner of the law firm serves as a director of the issuer.

#### 4. *Securities Law Problems*

Since the decision in *BarChris*, a doctrine has been developing in securities law that corporate counsel has a duty not only to the corporate entity and its stockholders but also to the investing public. This duty is compounded when corporate counsel also serves as a director. For example, the investigation by a lawyer-director of facts contained in a registration statement must be of a higher quality and of broader scope than that of directors generally, and must meet the professional standards owed by a lawyer to his client.<sup>72</sup> Because he is a lawyer as well as a director, the duties of the lawyer-director extend to both his corporate client and the investing public. Thus, to avoid liability under section 11 of the Securities Act, the lawyer-director would be required to show affirmatively that he met the statutory requirements of diligence and he could not escape malpractice exposure by interposing the usual attorney's exculpatory statements.<sup>73</sup> When wearing both hats, the lawyer-director assumes the heavy section 11 liabilities of a director while his due diligence defenses reflect the standards applicable to the attorney-client relationship.<sup>74</sup> For instance, in *BarChris* the lawyers were held liable because of their positions as directors, but the court also made special mention that the dual status of the lawyers increased their duties of reasonable investigation as directors.<sup>75</sup>

A decision based on a rationale similar to *BarChris* was *SEC v. Everest Management Corporation*.<sup>76</sup> Two attorneys were named as defendants and charged with securities fraud based on false SEC filings. One attorney was secretary of a defendant corporation. Again the role of a lawyer who was an insider by virtue of being a corporate director was significant. The same year *BarChris* was decided, the SEC obtained an injunction against a corporate attorney who did not verify information furnished him by the directors before including it in a prospectus.<sup>77</sup> The lawyer served his corporate client, but breached his duty to the offerees and purchasers of the client's securities.<sup>78</sup>

In *SEC v. National Student Marketing Corp.*,<sup>79</sup> defendant Meyer was

---

71. 283 F. Supp. 643 (S.D.N.Y. 1968).

72. *Id.* at 690, 692, 695-96.

73. Folk, *Civil Liabilities Under the Federal Securities Acts: The BarChris Case*, 55 VA. L. REV. 1, 37 (1969).

74. *Id.*

75. Shipman I, *supra* note 20, at 236.

76. No. 71-4932 (S.D.N.Y. Nov. 11, 1971). *See also* Blakely v. Lisac, 357 F. Supp. 255, 266 (D. Ore. 1972) (lawyer-director held liable in both capacities where he drafted a prospectus and knew or should have known that misleading information was set forth without his personal investigation of its accuracy).

77. *SEC v. Frank*, 388 F.2d 486 (2d Cir. 1968).

78. *Id.* at 488.

79. 457 F. Supp. 682 (D.D.C. 1978).

a stockholder and director of Interstate National Corporation, the company proposed to be merged into National Student Marketing Corporation. He was also a partner in the Chicago law firm which served as Interstate's outside legal counsel. Further, he was a personal friend and legal adviser to Interstate's president, Brown, and served as trustee of several trusts which held Interstate stock for Brown's children.<sup>80</sup>

The SEC charged Brown and Meyer with principal violations of the antifraud provisions of the securities acts in the merger and in subsequent transactions. The Commission also charged Meyer and one of his law partners with secondary liability as aiders and abettors,<sup>81</sup> and their law firm with vicarious liability because of the lawyers' activity on behalf of the firm.<sup>82</sup> The court found that Brown and Meyer had received information material to the merger and had "made a conscious decision not to disclose it."<sup>83</sup> They "expected to profit handsomely from the merger and the subsequent stock sales."<sup>84</sup> Brown and Meyer were held in violation of section 10(b), Rule 10b-5, and section 17 (a) as primary wrongdoers.<sup>85</sup> It is, of course, possible that Meyer's liability as a primary wrongdoer would have been imposed even had he not been a director of the corporation, but that circumstance cannot be ignored.

As to the aiding and abetting charges, the court found that Brown and "the attorney defendants (Meyer, his law partner, and his law firm)," had knowledge of the fraud and had provided "knowing, substantial assistance to the violation" by participating in the closing of the merger.<sup>86</sup> The court expressly held that "attorneys cannot rest on asserted 'business judgments' as justification for their failure to make a legal decision pursuant to their fiduciary responsibilities to client shareholders."<sup>87</sup>

Despite questions raised by some commentators,<sup>88</sup> when a lawyer is also a director of his client corporation it is likely that he will be charged with a duty to its stockholders and to the investing public to investigate information he receives in connection with an SEC registration statement or other filing, and to disclose any falsities he may discover. Corporate counsel, however, owes his position to management and, as a director, he becomes part of management. Because of the division of his loyalties among those to whom he owes obligations in both capacities, it will probably be a unique case in which those obligations do not conflict. Even the corporate lawyer who does not simultaneously serve as a director of his client corporation must recognize the emerging increase in the division of

---

80. *Id.* at 688.

81. *Id.* at 700.

82. *Id.* at 701.

83. *Id.* at 710-11.

84. *Id.* at 711.

85. *Id.* at 712.

86. *Id.* at 712-13.

87. *Id.* at 713-14.

88. *E.g.*, Karmel, *Attorneys' Securities Laws Liabilities*, 27 *BUS. LAW.* 1153, 1160 (1972).

his loyalties between the corporation and its investors-owners. Moreover, as Professor Shipman suggests, "management itself is entitled to know the extent of the attorney's division of loyalties."<sup>89</sup>

### 5. *What About Independence?*

Chairman Harold Williams of the Securities Exchange Commission has asserted that a "lawyer who is also outside counsel to a corporation, along with investment bankers, commercial bankers, and others who might be characterized as 'suppliers' to the corporation, should be excluded from board membership."<sup>90</sup> He recognizes that "legal counsel frequently has special knowledge of litigation and other matters of vital significance to directors," but cites several competing factors:

It is important that we come to grips with the conflict of interest problem created by the board membership of those whose income, in some significant measure, depends upon their business dealings with the management; with the obvious inhibitions on the other members of the board in terminating or criticizing the service rendered the corporation as a result of another director's business relationship; and with the public perception problem created by that conflict.<sup>91</sup>

The point made by Chairman Williams is that outside counsel of the corporation is not independent of management because his board membership, in a significant manner, depends upon his dealings with management. Outside counsel is to some degree, at least, economically dependent upon the corporation's business in his professional life.<sup>92</sup> Can a lawyer, in such a position, afford to be an "inside" director of his client corporation? Should he be a director at all, considering his professional status, responsibility, and personal liability?

Thirty years ago, one writer expressed the belief that the practice of lawyers serving as directors of their client corporation was "too widespread to permit any . . . expectation" of a change.<sup>93</sup> The climate is different now. Litigation against corporate officers and directors presently consumes much court time and lawyers are being named as defendants with increasing frequency.

In the Airlie House Conference on "Ethical Responsibilities of Corporate Lawyers,"<sup>94</sup> the participants considered adding a provision to the Code of Professional Responsibility which stated that it would be

---

89. Shipman I, *supra* note 20, at 286.

90. Williams, *Corporate Accountability and the Lawyer's Role*, 34 BUS. LAW. 7, 10 (1978).

91. *Id.* at 10-11.

92. Leech & Mundheim, *The Outside Director of the Publicly Held Corporation*, 31 BUS. LAW. 1799, 1830 (1976).

93. Swaine, *Impact of Big Business on the Profession: An Answer to Critics of the Modern Bar*, 35 A.B.A. J. 89, 170 (1949).

94. *The Airlie House Conference on Ethical Responsibilities of Corporate Lawyers*, 33 BUS. LAW. 1173 (1978).

unprofessional for corporate counsel to serve on the board of any publicly held company that he advises.<sup>95</sup> Underlying such proposals is the public's expectation that a corporate lawyer should have a measure of independence that will permit him to supply high quality legal advice untainted by conflicts of interest, economic or otherwise.<sup>96</sup> This concern is suggested by the New York Stock Exchange's Audit Committee Policy: "Directors who are affiliates of the company or officers or employees of the company or its subsidiaries would not be qualified for Audit Committee membership."<sup>97</sup>

Professor Robert H. Mundheim, who led the Airlie House discussion of this point, noted that "courts expect more of a lawyer-director than they do, for example, of a sociology professor-director."<sup>98</sup> Moreover, when the interests of management and the corporation diverge, the problem is compounded if the company's lawyer also serves as a director. The dual role makes it difficult for the lawyer-director to act independently, and it restrains the freedom of the corporation to change counsel, or to transfer some business from the lawyer-director's law firm.<sup>99</sup>

Whether employed as in-house counsel or as a partner in an outside law firm, a corporation's chief legal counsel must consider and advise the corporation of all possible adverse legal consequences that may flow from any laws and regulations and must make legally oriented decisions. If he is, also a director, he will be obligated to exercise his business judgment, which may not square with his legal opinion. To complicate matters, he may be confronted with the risk of losing a valued client, perhaps his only client.<sup>100</sup> In such a dilemma, can a lawyer-director subject the corporation's problems to a dispassionate and unbiased review in either capacity?

In the Airlie House discussion following Professor Mundheim's presentation, the trend was to recognize the seriousness of such problems and their bearing upon the lawyer's effectiveness in either capacity.<sup>101</sup> One panelist who considered it "a little bit unrealistic to think of lawyers as being entirely independent," inquired: "[I]s a lawyer who is receiving big fees from a company [and who is] . . . not a director of that company, likely to be any more independent in advising that company or serving its management than the same lawyer who serves as a director?"<sup>102</sup>

He went on to respond to his own question,

---

95. Mundheim, *Should Code of Professional Responsibility Forbid Lawyers to Serve on Boards of Corporations for Which They Act as Counsel*, 33 BUS. LAW. 1507 (1978).

96. *Id.* at 1512.

97. W. KNEPPER, *supra* note 42, at 801.

98. Mundheim, *supra* note 95, at 1507.

99. *Id.* at 1509.

100. *Id.*

101. *Id.* at 1512 (discussion following Mundheim article).

102. *Id.* at 1514 (remarks of Kenneth J. Bialkin).

Now, the lawyer-director has the same duty of loyalty to the corporation as other directors. He may be friendly and sympathetic to management—he probably would not be the lawyer or a director if he were not—but he must be objective and prepared to disagree with management as circumstances require. . . . In fact, I am aware of examples where it was the lawyer on the board, acting as a director, who was most vigorous in questioning management proposals, challenging assumptions, and clarifying issues for board consideration.<sup>103</sup>

Nonetheless, the discussion disclosed substantial support for the view that major suppliers of services to a corporation should not serve as directors, that the corporation's lawyer should attend board meetings, but should do so as a lawyer only, and that leading law firms follow these practices.<sup>104</sup>

### 6. *Attorney-Client Privilege*

The clear trend of the decisions is that the policy of the law imposing fiduciary duties upon directors and officers will override any claim of attorney-client privilege based on the fact that a director is the corporation's lawyer.<sup>105</sup> One court has stated: "When the attorney and the client get in bed together as business partners, their relationship is a business relationship, not a professional one, and their confidences are business confidences unprotected by a professional privilege."<sup>106</sup>

The acts of a lawyer-director and his knowledge as a director cannot be separated from his acts and his knowledge as a partner in his law firm.<sup>107</sup> His fiduciary obligations as a director and his professional obligations as a lawyer cannot "be placed in convenient separate boxes."<sup>108</sup> The knowledge of a corporate director and officer, with respect to transactions in which he is authorized to act, is imputed to the corporation. Similarly, the knowledge of a partner in a law firm, gained during confidential relationships with clients, is imputed to the other partners in the law firm.<sup>109</sup> In a proper case, the files and work processes of the law firm are as available for discovery as are the files and records of the corporation itself.<sup>110</sup>

When the Fifth Circuit, in deciding *Garner v Wolfinbarger*,<sup>111</sup> refused to apply attorney-client privilege as a "veil of secrecy" between a corporation's management and its stockholders, it recognized that there

103. *Id.*

104. *Id.* at 1511, 1516-18.

105. See, e.g., *In re Transocean Tender Offer Securities Litigation*, 78 F.R.D. 692 (N.D. Ill. 1978); *Federal Savings & Loan Ins. Corp. v. Fielding*, 343 F. Supp. 537, 545 (D. Nev. 1972).

106. 343 F. Supp. at 546.

107. *Marco v. Dulles*, 169 F. Supp. 622, 631 (S.D.N.Y.), *appeal dismissed*, 268 F.2d 192 (1959).

108. *Id.*

109. *Federal Savings & Loan Ins. Corp. v. Fielding*, 343 F. Supp. 537, 544 (D. Nev. 1972).

110. E.g., *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

111. *Id.*

may be many situations in which the corporate entity or its management, or both, have interests adverse to those of some or all stockholders.<sup>112</sup> The court declared that "management judgment must stand on its merits, not behind an ironclad veil of secrecy which under all circumstances preserves it from being questioned by those for whom it is, at least in part, exercised."<sup>113</sup> To like effect is the Delaware case in which a controlling stockholder's general counsel sat as a director of a subsidiary corporation. Attorney-client privilege was denied as to communications affecting the interests of minority stockholders.<sup>114</sup>

If the lawyer-director is an inside director, as the above discussion suggests, he will be a part of the corporation's control group, which is entitled to assert attorney-client privilege in the ordinary situation.<sup>115</sup> The fiduciary obligations of the lawyer-director to each individual stockholder,<sup>116</sup> however, will override the attorney-client privilege where the two come into conflict. Thus memoranda and opinions prepared by him will probably be treated as nonprivileged documents provided by a director rather than confidential advice furnished by a lawyer to his client.<sup>117</sup> This prospect has startling implications.

### 7. *A Deputy For His Law Firm?*

When a partner in an outside law firm that is counsel for a corporation becomes a member of the client's board of directors, is the arrangement between the law firm and the corporation so close that the partner-director can be considered to have been deputized by the law firm as its representative on the board?<sup>118</sup> In *Lanza v. Drexel & Co.*,<sup>119</sup> one of the *BarChris* progeny,<sup>120</sup> the plaintiff tried to hold the underwriting firm liable because of breaches of duty by Coleman, a Drexel partner, who was also a *BarChris* director. The case raised the question whether Coleman had been deputized by Drexel to serve as its representative on the *BarChris* board. In the district court Judge Frankel also considered the liability of Coleman and Drexel as controlling persons under section 20 (a) of the Securities Exchange Act.<sup>121</sup>

---

112. *Id.* at 1101.

113. *Id.*

114. *Valente v. Pepsico, Inc.*, 68 F.R.D. 361, 368 (D. Del. 1975).

115. *See, e.g., Radiant Burners, Inc. v. American Gas Ass'n*, 320 F.2d 314 (7th Cir.) *cert. denied*, 375 U.S. 929 (1963).

116. *Grognet v. Fox Valley Trucking Service*, 45 Wis. 2d 235, 172 N.W.2d 812 (1969).

117. *See Hershman, Special Problems of Inside Counsel for Financial Institutions*, 33 Bus. Law. 1435, 1440 (1978).

118. *Shipman II*, *supra* note 29, at 283-84.

119. [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶92,826 (S.D.N.Y. 1970), *aff'd*, 479 F.2d 1277 (2d Cir. 1973) (en banc).

120. *See* text accompanying note 71 *supra*.

121. 15 U.S.C. § 78t (1976). *See Shell v. Hensley* 430 F.2d 819 (5th Cir. 1970). *See also* 15 U.S.C. § 77(o) that is the comparable provision, section 15, of the Securities Act.

The concept of deputization has been applied in section 16 (b)<sup>122</sup> short-swing profits cases. For instance, in *Feder v. Martin Marietta Corp.*, the Second Circuit Court of Appeals held that Martin Marietta Corporation, by a resolution of its board of directors, had deputized its president to represent its interests as a director of Sperry Rand Corporation.<sup>123</sup> The court held in effect that Martin Marietta, acting through its president, was a director of Sperry Rand.<sup>124</sup> In the same vein, it has been suggested that a partner in a law firm should not purchase or sell securities of his firm's corporate client without first making sure that no inside-information problem exists that might result in Rule 10b-5 liability.<sup>125</sup>

In construing section 15 of the Securities Act and section 20 (a) of the Exchange Act the courts have focused on the power or potential power of the alleged controlling person to influence and control the actions of another.<sup>126</sup> Although something more than *respondeat superior* has been required to impose liability in such cases,<sup>127</sup> it seems likely that in a proper case, a law firm could be held liable as a controlling person for the dereliction of one of its partners serving as a director of one of its corporate clients.

### 8. Significant Conflicts of Interest

Conflicting interests have become of increasing concern in recent years, and the tactic of demanding the disqualification of trial counsel in complex business litigation is a recognized technique of trial strategy.<sup>128</sup> A predictable by-product of that trend is to question the conflicts confronting a corporate lawyer who becomes a member of his client's board of directors.

Professor Andrew Kaufman<sup>129</sup> tells the story of George Templeton Strong, a partner in the law firm of Cadwalader, Wickersham and Taft, who was selected to be a director of the Bank for Savings, for which his law firm was counsel. More than a century ago, he wrote that this meant he would no longer be able to share in the law firm's earnings derived from

---

122. 15 U.S.C. § 78p(b) (1976).

123. *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 265 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970).

124. *Id.* See also *Blau v. Lehman*, 368 U.S. 403 (1962); *Lowey v. Howmet Corp.*, 424 F. Supp. 461 (S.D.N.Y. 1977).

125. *Harris*, *supra* note 40, at 62-63.

126. *E.g.*, *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 890-91 (3d Cir. 1975).

127. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n.28 (1976), *reh. denied*, 425 U.S. 986 (1976); *Lanza v. Drexel & Co.*, [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶92,826 (S.D.N.Y. 1970), *aff'd*, 479 F.2d 1277 (2d Cir. 1973) (en banc).

128. *E.g.*, *International Business Machines Corp. v. Levin*, 579 F.2d 271 (3d Cir. 1978); *First Wisconsin Mortgage Trust v. First Wisconsin Corp.*, 584 F.2d 201 (7th Cir. 1978); *Cinema 5, Ltd. v. Cinema, Inc.*, 528 F.2d 1384 (2d Cir. 1976); *City of Cleveland v. Cleveland Electric Illuminating Co.*, 440 F. Supp. 193 (N.D. Ohio 1977), *aff'd*, 573 F.2d 1310 (6th Cir. 1977), *cert. denied*, 435 U.S. 996 (1978).

129. Professor of Law, Harvard Law School.



fees paid to it by that bank.<sup>130</sup> Such financial screening would probably be unusual today. It has been said that the "ethical problems of a corporate law firm are more than the sum of its parts" and that as "the number of lawyers, clients, and particular matters" increases, "the number of ethical problems increases exponentially."<sup>131</sup> Conflict of interest is, of course, a primary source of such ethical problems.

It is not unusual, in today's complex business climate, for conflicts of interest to occur between such groups as controlling majority stockholders and public minority stockholders, the active promoters of a new business and the passive suppliers of its capital, incumbent management and stockholders who seek to replace such management, holders of different classes of stock, or different factions of stockholders, each seeking to enhance its own position.<sup>132</sup> In such cases, what responsibility does the corporate attorney have to persons other than the incumbent management of the corporation? If he is also a director, does that create any additional conflicts of interest?<sup>133</sup>

The Code of Professional Responsibility contains language applicable in more or less degree to various circumstances, but it provides few specific guidelines to particular problems, especially those of the lawyer-director. In any event, there is no certainty that conformity to the Code will relieve lawyers of a duty to comply with such higher standards as courts may deem appropriate.<sup>134</sup> The attitude of the SEC that securities lawyers must be more conscious of their public responsibilities gives the bar no reason for complacency.<sup>135</sup>

In the 1974 revision of the Model Business Corporation Act, the ABA committee concluded that stockholder and public expectations of corporate responsibility and director performance require a standard of care reasonably applicable to every director regardless of the individual's personal or professional qualifications or how he happened to be chosen for election.<sup>136</sup> Thus came the standard, "as an ordinarily prudent person would use under similar circumstances in a like position."<sup>137</sup> This standard follows Judge McLean's position in *BarChris*<sup>138</sup> and takes into consideration a director's special background, qualifications, knowledge, and expertise.

The corporation's lawyer who serves also as a director must be

130. *The Airlie House Conference*, *supra* note 94, at 1191.

131. Cutler, *The Role of the Private Law Firm*, 33 BUS. LAW. 1549 (1978).

132. W. KNEPPER, *supra* note 42, at 423; Marsh, *supra* note 21, at 1227.

133. See discussion in Marsh, *supra* note 21, at 1228-34.

134. See generally *United States v. Simon*, 425 F.2d 796, 805-06 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 703 (S.D.N.Y. 1968).

135. See e.g., *SEC v. National Student Marketing Corp.*, 457 F. Supp. 682 (D.D.C. 1978).

136. Coombe, *Lawyers as Directors: Application of Statutory Standard of Care*, 30 (Special Issue) BUS. LAW. 41, 45 (1975) (panel discussion).

137. See W. KNEPPER, *supra* note 42, at 112-113; *Comment on Amendments to Section 35 of the Model Business Corporation Act*, 32 BUS. LAW. 42, 45 (1976).

138. See text accompanying note 43 *supra*.

conscious of the potential for conflicting interests in these two roles. He is admonished, in the words of Mr. Justice Story, to have "no interest, which may betray his judgment, or endanger his fidelity."<sup>139</sup> He was probably chosen as a director by the corporate management, and most likely chosen by its chief executive. His law firm was also chosen as legal counsel by management and is responsible to it in the first instance.<sup>140</sup> The power to dismiss directors and legal counsel is typically vested in the chief executive<sup>141</sup> so that, in both capacities, the lawyer-director is economically dependent upon the chief executive.<sup>142</sup> In that respect, however, his conflicts of interest are probably no greater in the dual capacity than as a director or as corporate counsel. Also, they are not much different than those of an outside director who is a lawyer but is not counsel for the corporation.

It has been said that permitting the corporation's outside legal counsel to sit on the board severely compromises his objectivity, since he is then simultaneously attorney and client.<sup>143</sup> Whether that constitutes legal malpractice has yet to be established, but an action early in 1979 by special counsel for International Controls Corporation seeks damages from a Washington law firm for malpractice, for the return of all legal fees, and for the return of director's fees paid to one of its partners who served on the ICC board of directors during the time that Robert Vesco directed the company's operations.<sup>144</sup>

What happens when a derivative action or a class action is brought by stockholders against management to impose liability for securities fraud or wrongdoing in the management of the corporation? The common practice has been to allow corporate counsel to represent management and for independent counsel to appear for the corporation.<sup>145</sup> The practice is justified on the theory that corporate counsel is, in fact, closely allied with management, the officers and directors have relied upon his advice, and he should be allowed to defend his own work and advice when it is under attack.<sup>146</sup> The joint client theory of *Garner v. Wolfinbarger*<sup>147</sup> may complicate this situation. If the lawyer, *qua* lawyer or *qua* director, has a potential liability to the corporation, his interests could conflict with those of the corporation and preclude such representation.<sup>148</sup>

139. *Williams v. Reed*, 29 F. Cas. 1386, 1390 (C.C. Maine 1824) (No. 17,733).

140. See Eisenberg, *Legal Models of Management Structure in the Model Corporation: Officers, Directors, and Accountants*, 63 CAL. L. REV. 375, 382 (1975).

141. *Id.* at 408.

142. *Id.* at 382.

143. *Id.* at 405.

144. Hager, *Clear Skies Ahead for Hogan and Hartson?*, Legal Times of Wash., Jan. 15, 1979, at 28, col. 1, at 2-3.

145. Shipman II, *supra* note 29, at 280.

146. *Id.* See *Lewis v. Shaffer Stores Co.*, 218 F. Supp. 238, 239 (S.D.N.Y. 1963); *Marco v. Dulles*, 169 F. Supp. 622 (S.D.N.Y.), *appeal dismissed*, 268 F.2d 192 (1959).

147. See text accompanying notes 25-29 *supra*.

148. Shipman I, *supra* note 20, at 256. See also *Fogel v. Chestnutt*, 533 F.2d 731 (2d Cir. 1975), *cert. denied*, 429 U.S. 824 (1976).

The conflicts are compounded if the lawyer is a defendant in the action, either *qua* lawyer or in his dual capacity as lawyer-director. He may be disqualified from representing the corporation in such a case.<sup>149</sup> When a lawyer-director and his fellow directors were joined as defendants, the Second Circuit held that his law firm could not represent all of them. It found a danger of conflict of interest if the directors should contend they did only what the lawyer said was lawful, and if the lawyer should contend that he wrote only what the other directors told him was true.<sup>150</sup>

The trend of the decisions in this area is to resolve all doubts regarding conflict of interest in favor of the disqualification of the lawyer from serving as counsel in the litigation.<sup>151</sup>

### 9. Liability Insurance Coverage

It is assumed that the lawyer-director's law firm will carry adequate professional liability insurance<sup>152</sup> and that the corporation will purchase directors' and officers' (D & O) liability insurance with sufficient limits.<sup>153</sup> Nevertheless, the lawyer-director may still have serious problems arising out of wearing his two hats.

The liabilities a lawyer assumes when acting as a corporate director or officer are commonly outside his professional liability policy.<sup>154</sup> The policy usually undertakes to pay all sums which the insured may become legally obligated to pay on account of any act, error, or omission in professional services rendered or that should have been rendered and arising out of the conduct of his profession as a lawyer.<sup>155</sup> His services as a corporate director do not arise out of the conduct of his profession as a lawyer.

The D & O policy covers him as a director or officer of the corporation for loss, with some exclusions, on account of a wrongful act in his capacity as such director or officer.<sup>156</sup> Legal services are not performed in this capacity as a director or officer.

If, because of his status as a director, the lawyer-director incurs liability as a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA)<sup>157</sup> he will need additional liability insurance coverage under a fiduciary liability insurance policy. ERISA liability will not be covered by his professional liability policy and probably not by the corporation's D & O policy.<sup>158</sup>

Most professional liability policies exclude coverage for claims

---

149. *Harrison v. Keystone Coca-Cola Bottling Co.*, 428 F. Supp. 149 (M.D. Pa. 1977).

150. *International Elecs. Corp. v. Flanzer*, 527 F.2d 1288, 1296 (2d Cir. 1975).

151. *International Business Mach. Corp. v. Levin*, 579 F.2d 271, 283 (3d Cir. 1978).

152. *W. KNEPPER*, *supra* note 42, at 654-58.

153. *Id.* at 619-46.

154. *Shipman II*, *supra* note 29, at 283.

155. *Gates & Zilly*, *supra* note 14, at 332; *W. KNEPPER*, *supra* note 42, at 655-56.

156. For a more detailed description of the coverage, see *W. KNEPPER*, *supra* note 42, at 628-37.

157. 29 U.S.C. §§ 1001-1381 (1976).

158. *W. KNEPPER*, *supra* note 42, at 646-51, 654-58.

arising out of securities law violations unless substantial additional premiums are paid.<sup>159</sup> This exclusion may deny coverage for transactions not traditionally thought to involve securities, such as legal work related to condominium units, community clubs, and limited partnership interests. Moreover, the exclusion may apply to unregistered securities such as the shares in a small corporation sold to a limited number of investors.<sup>160</sup>

When SEC coverage is not excluded, it still may not cover all potential liability under the securities acts.<sup>161</sup> Much securities litigation is based on allegations of fraud. The professional liability policy excludes coverage for dishonest, fraudulent, criminal, or malicious acts or omissions.<sup>162</sup> In the D & O policy, there is usually an exclusion of loss arising because a director acted dishonestly or in bad faith with knowledge or reasonable cause to believe that his action was in violation of law. Such an exclusion seems broad enough to apply to private damage claims under Rule 10b-5, based on "scienter" as defined in *Ernst & Ernst v. Hochfelder*,<sup>163</sup> unless the action taken was merely reckless, in good faith, and without knowledge of or reason to believe in illegality.<sup>164</sup>

If the lawyer-director is held to be a deputy for his law firm, it is doubtful whether his partners and his law firm will be covered for vicarious liability imposed upon them because of his derelictions as a corporate director and not as an attorney.

### III. CONCLUSION

There are no general or ABA prohibitions against corporate counsel also serving as a corporate director.<sup>165</sup> However, a member of the law firm, which is outside counsel to a publicly-held corporation, who puts on a second hat as a corporate director assumes substantial additional responsibilities and, in today's legal climate, compounds his already complex liability picture.

Plaintiffs' attorneys continue to search for the "deep pocket" from which to obtain large settlements or collect substantial judgments. Lawyer-directors, potentially insured by large liability insurance policies, make ideal targets, especially in those cases where the prime culprits have become judgment proof.<sup>166</sup>

---

159. Gates & Zilly, *supra* note 14, at 333; W. KNEPPER, *supra* note 42, at 657.

160. Gates & Zilly, *supra* note 14, at 324.

161. See Call, *Attorneys' Malpractice Insurance—Does Your Policy Cover Rule 10b-5 Liability?*, 30 BUS. LAW. 1095 (1975).

162. W. KNEPPER, *supra* note 42, at 656.

163. 425 U.S. 185, 193 (1976), *reh. denied*, 425 U.S. 986 (1976).

164. W. KNEPPER, *supra* note 42, at 634. See also *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir. 1977).

165. Shipman II, *supra* note 29, at 283.

166. W. KNEPPER, *supra* note 42, at 654.